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SUBJECT: IMF MISSION HOPES FOR U.S. SUPPORT ON SENEGAL'S PSI AT
REVIEW BOARD

REF: DAKAR 1246 AND PREVIOUS

DAKAR 00001298 001.2 OF 003

1. (U) This cable is sensitive but unclassified and should not be shared outside of approved USG channels.

2. (SBU) SUMMARY: Senegal's Policy Support Instrument with the IMF faces a critical Board Review and assessment in December. The Mission carrying out the second review of the program has returned to Washington and hopes to better understand the USG's likely position on maintaining the IMF's current engagement with Senegal. Work is continuing on a new memorandum of agreement between the IMF and Senegal's Ministry of Finance, but needs to be completed by November 30. Key issues still on the table include verifying the current budget gap needing immediate financing to pay arrears to the private sector, and also near-term corrective measures to be implemented by Finance and Treasury officials. We would like to see a stronger commitment to strict public finance control and management from the highest levels of the GOS, but also assess tremendous risk to reform efforts should there be any gap in active IMF engagement in Senegal. END SUMMARY.

PERSONAL APPEAL FOR U.S. SUPPORT

3. (SBU) On three occasions during his latest two-week mission to Senegal, the IMF Mission Chief for Senegal's Policy Support Instrument (PSI) program Johannes Mueller asked Ambassador Bernicat and Econ Counselor for our assessment of the "sense in Washington" for continued support for the IMF's engagement with Senegal. Mueller was up-front on noting the ongoing difficulties with the program, but he also highlighted real progress towards a new memorandum of agreement that would include strict conditionality. Mueller returned to Washington by November 10, and by November 11 or 12 will be in discussions with IMF Administrators on this latest (the second) program review. Mueller mentioned that IMF officials may want to consult with appropriate Treasury and State officials.

4. (SBU) In brief, Mueller requested USG support for the program (or some program) at the December IMF Board review for a number of reasons:

-- a failure in the program would be taken as a "slap in the face" to the GOS, particularly at this time when the IMF is actively helping middle-income countries climb out of financial crisis;

-- a negative review could lead to the dismissal of Finance Minister Diop, who is viewed as a knowledgeable and helpful interlocutor, and a key player for implementing important public finance reform;

-- any break in an IMF program with Senegal would likely have disastrous consequences by allowing continued abuse via extra-budgetary spending and would stop the current momentum towards improved accountability and reform;

-- the IMF's progress with the Finance Ministry on improving Senegal's 2009 budget framework and application could be lost.

IMF, MINFIN STILL WORKING ON A PLAN TO RESCUE SENEGAL'S BUDGET

15. (SBU) At the end of his two-week assessment visit, on November 7, IMF Mission Chief Johannes Mueller briefed a large assemblage of donors on the status of the second review of Senegal's PSI program. Earlier in the mission, Mueller and IMF ResRep Alex Segura briefed Ambassador Bernicat privately and with a select group of other key Chiefs of Mission, both to provide some additional insight into the review and negotiations with Finance Minister Abdoulaye Diop, and also to ask about the likelihood that Washington and other Capitals will continue to support Senegal's program.

16. (SBU) Mueller departed Dakar without a final text for a new memorandum of agreement between the GOS and the IMF, but he told the donors that additional information should be available in the coming week after additional verification of Senegal's internal debt and concluding agreement on new "corrective measures." The report needs to be completed no later than November 30 for the IMF Board's review. According to Mueller, the agreement needs to focus on three priorities:

-- setting five to ten "immediately needed" corrective measures, which will be drawn from the current review and the sixty-plus recommendations presented by the recent IMF investigative mission (Mueller was not willing to specify what these measures will be). [Note: the Minister of Finance has agreed to share the

DAKAR 00001298 002.2 OF 003

investigative mission's report and recommendations with the donors who comprise the Public Finance Working Group, who are the donors that provide direct budget support and/or technical assistance to the Ministry of Finance. We are not a member of this group, but hope to get a copy of the report. End note];

-- resolution of some ongoing data collection problems in order to verify budget gaps and inappropriate expenditures. [Note: the IMF's current estimate of Senegal's internal debt is based on expenditures from 2008 only. The IMF hopes to finalize its assessment for 2007 within a couple of weeks, and then continue its review into Senegal's expenditures from 2005-2006, which admittedly could dig up additional fiscal irregularities and debt. End note];

-- Senegal needs to have made credible progress on financing its budget gap by the end of the year. Mueller was somewhat vague on what this meant exactly, at first saying that Senegal needed to complete its financing, but later acknowledging that there is likely not enough time to secure new credit and make all necessary payments on the arrears owed to the private sector before the end of the year.

THE BUDGET GAP IS STILL A MOVING TARGET

17. (SBU) Mueller admitted that they may not be able to verify exactly how big the 2008 budget gap is, how it evolved, or who is owed money. However, the IMF is apparently focusing on only the most critical impacts of the deficit, the debts owed to the private sector ("instance du payment"). At the most recent briefing he stopped using the term "arrears." Earlier on November 7, at the periodic review of the GOS-Donor Consultative Group process, MinFin Diop claimed that the Senegal's internal debt (for purposes of the IMF review) was CFA 174 billion (approximately USD 350 million). Mueller noted to the Ambassador that he expects the target figure to be around CFA 225 billion.

18. (SBU) For his part, President Wade has recently claimed that Senegal's internal debt is "only" CFA 130 billion, while business associations and the press have fixed on a figure of CFA 300 billion

(which is reportedly the amount of a loan the government is trying to negotiate with France to pay "much of" the private sector arrears). Recently, a former Finance Minister in the Diouf administration has claimed the real internal debt is more than CFA 500 billion. As reported in reftel, some of our contacts at the Ministry of Finance and Treasury have apparently been tasked with figuring out how to raise close to CFA 475 billion.

REPORTS AND OPTIONS FOR THE BOARD

¶9. (SBU) Mueller was pragmatic in discussing the difficult review that will face the IMF board, scheduled for December 18. There is no certainty that the Board will give a positive review. If a negative review is put forth, it would apparently be a first for a country under a PSI. It may be possible that the board will decide that the second review was not completed, and then the future of Senegal's PSI would rest entirely on the third review, which will take place in March, 2009. There is also the possibility of discussing a near-term transition from the PSI to a traditional Poverty Reduction and Growth Facility (PRGF), which could perhaps include some disbursement of fiscal support (around CFA 30 billion was bandied about). Mueller expressed rightful concern that such a shift in program could leave Senegal with no program for a matter of months, potentially opening a window for new abuses of the country's Treasury.

¶10. (SBU) According to Mueller, a strong case could be made that Senegal meets the criteria for the IMF's new Exogenous Shock Facility (ESF) since the country clearly suffered a major budget hit with last summer's increases in energy and food prices -- although the fiscal shock was exacerbated by the GOS's non-removal of energy and food subsidies, a step now almost completed. There was some speculation that Senegal might benefit from around CFA 30 billion in assistance under an ESF, but Mueller was clear that no country under a PSI has yet been considered for this assistance, and it might not be possible.

¶11. (SBU) In addition, the IMF Board will need to address other areas where Senegal has not met its PSI obligations, perhaps calling for specific Reports. These could include admissions by the GOS of misreporting fiscal data in 2007, and, perhaps, agreeing to non-concessional external financing.

DAKAR 00001298 003.2 OF 003

MORE NEGATIVE NEWS ON ECONOMIC DATA

¶12. (SBU) The impact of the non-payments to the private sector continues to drag down Senegal's economic performance. Mueller provided updated, more pessimistic figures for some key indicators. The IMF estimates 2008 GDP growth at 3.9 percent (which is still better than the GOS's internal estimate of 3 percent), despite an estimated 15 percent increase in agriculture production. In addition to the arrears, the continuing underproduction by phosphates giant ICS is slowing growth. Mueller estimates that medium term growth should move back to the five percent range (which remains well below the target 7-plus GDP growth under the GOS' Accelerated Growth Strategy). 2008 inflation will likely register at 6.9 percent, but the Mission estimates a drop to 3.3 percent in ¶2009. Senegal's balance of payments deficit over the next 12 months is estimated at 12-13 percent of GDP. The country's 2008 budget deficit is now estimated at three percent of GDP.

POSITIVE SPIN FOR 2009

¶13. (SBU) Looking forward, Mueller highlighted some positive steps being taken as a result of the IMF's engagement. With IMF assistance, the Ministry of Finance finally put forward the corrected, revised budget legislation for 2008 ("loi de finance rectificative"), which is currently being reviewed in the National Assembly. Also, according to Mueller, Senegal's 2009 budget will for the first time fully conform to the IMF-approved macroeconomic framework, and should significantly control the discretionary spending among line ministries. The 2009 budget should also significantly reign-in investment spending -- which was source of much of the extra-budgetary commitments made by ministries and

agencies in past years.

¶14. (SBU) Mueller claims that in theory Senegal has a good framework and internal control mechanisms available, including effective tracking and audit software and systems. However, more work needs to be done, along with additional donor technical assistance, in order to better utilize these systems. He underscored that the recommendations presented by the IMF investigative team are a good starting point. A similar team may return to Dakar in November 2009, to help the Ministry of Finance and the Treasury achieve a "global standard" in public finance management and control.

COMMENT

¶15. (SBU) The IMF, and particularly Segura, deserves credit for doggedly digging up fiscal irregularities created, and buried, by a number of ministries and senior government officials. However, we are not yet convinced that the IMF has discovered all of the budget holes or the depth of Senegal's fiscal crisis. That said, the IMF's current focus on the private sector arrears, along with strong measures to improve future fiscal accountability is perhaps the best course available. While we would hope to see some effort to enforce accountability, and also public statements of determined political will from not only the Finance Minister but also President Wade to protect the country's public finances, that is likely a goal too distracting from the immediate need of getting money into the private sector and banks before the economy completely stalls.

¶16. (SBU) Though serious questions still need to be asked of Mueller and Minister Diop on the yet-to-be-finalized memorandum and the next steps, we hope that there will be no suspension or gap in the IMF's program (PSI or PRGF) with Senegal. Many of the budget manipulation practices that have so greatly impacted the country's Treasury were first instigated during the time that Senegal had completed its previous PRGF but had not yet signed on to the PSI.

¶17. (SBU) Apart from the current crisis, there remains much that the MinFin needs to institute to bring control back to Senegal's public finances: implementing mechanisms for greater transparency, assuring protection against extra-budgetary commitments, slowing the continued expansion of "black" budgets at the presidency and some other ministries, assuring full conformity to the GOS' own public procurement codes, committing to a renewed commitment to proper use of HIPC and MLD relief, assuring against high levels of new debt, and improving utilization of current fiscal systems. Technical assistance by donors will continue to play a key role.

BERNICAT